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No. 97-1418

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Petitioner,
v.
203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

Pursuant to Rule 37.2(b) of this Court, the American Council of Life Insurance ("ACLI") respectfully moves this Court for leave to file the accompanying brief *amicus curiae* in support of the Petition for Writ of Certiorari filed by Bank of America National Trust and Savings Association. Petitioner has consented to the filing of this brief, and petitioner's written consent has been filed with the Clerk of the Court. Respondent has refused its consent.

ACLI is the principal national trade association of life insurance companies in the United States. Its members have a significant stake in the resolution of the question presented in this case. Life insurance companies are a major source of investment capital, providing more than ten percent of institutional funds flowing into U.S. finan-

cial markets in 1996 and holding more than $1 trillion in corporate bonds and mortgages as of year-end 1996.

ACLI participated as *amicus curiae* when the question presented in this case was last before the Court four Terms ago in *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, No. 93-714. Although the Court did not reach the merits in that case, ACLI believes that its briefs at the petition stage and on the merits provided the Court with a valuable perspective on the importance of the issue and the proper resolution of the question on the merits. ACLI believes that its views in this case will be equally valuable to the Court.

WHEREFORE, ACLI respectfully requests that the Court grant it leave to file the accompanying brief *amicus curiae* in support of the Petition for Writ of Certiorari.

Respectfully submitted,

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BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE* [1]

ACLI is the principal national trade association of life insurance companies. The 532 member companies of ACLI account for eighty-nine percent of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1996, life insurance companies' net investment in U.S. money and capital markets totaled $107 billion, more than ten

[1] In accordance with Supreme Court Rule 37.6, ACLI represents that no party other than counsel for ACLI authored this brief in whole or in part, and no person or entity, other than ACLI, has made a monetary contribution to the preparation of submission of this brief.

percent of total institutional funds flowing into the financial markets. American Council of Life Insurance, *Life Insurance Fact Book* 50 (1997). At year-end 1996, life insurers held $951.7 billion in corporate bonds and $207.8 billion in mortgages. *Id.* at 53, 102.

The interest of ACLI as *amicus* arises out of the importance of this case to the commercial lending community. As a principal source of investment capital for both real estate developments and operating businesses, life insurance companies have a broad and important perspective on the need for this Court's review of this case.

Life insurance companies, like all lenders, presently are faced with conflicting rules as to the propriety of a bankruptcy reorganization plan that grants the debtor's owners ("old equity"), and only old equity, the right to purchase ownership of the reorganized debtor by contributing additional capital to the debtor's bankruptcy estate (an "equity-only new value right"). The courts of appeals, district courts, and bankruptcy courts are divided on whether the Bankruptcy Reform Act of 1978, 11 U.S.C. § 101 et seq. (as amended, the "Bankruptcy Code") permits an equity-only new value right, as are the law review and treatise writers.

Lenders make credit decisions, price loans, and bargain for security and other terms based in part on the risks of nonpayment and the potential for recovery in the event of default. Lenders (and borrowers) need a uniform national rule of bankruptcy rights and priorities. Uncertainty as to the rights and priorities of debt holders and equity holders adversely affects credit decisions, the cost of credit, and the consensual resolution of troubled loans. Review of the decision of the Court of Appeals is thus vitally important to ACLI and its members.

SUMMARY OF REASONS FOR GRANTING THE WRIT

The five courts of appeals that have considered the issue presented in this case—whether an equity-only new value right meets the requirements of the Bankruptcy

Code's absolute priority rule—are divided. This division at the appellate level reflects a split in the bankruptcy courts, sometimes among judges in the same judicial district. A decision from this Court on the merits is necessary to establish a uniform nationwide rule of decision.

The equity-only new value question is an issue of great importance to both creditors and debtors. Clarification of this area of the law will remove significant uncertainties from the processes of negotiating and litigating bankruptcy reorganization plans and will enable the credit markets to allocate bankruptcy-related risks appropriately. This Court recognized the importance of this issue by granting certiorari in *Bonner Mall* four Terms ago.

The Court of Appeals in this case disregarded the significance of Congress' deliberate statutory choices in enacting the Bankruptcy Code in 1978 and misread the plain language of the statute that resulted from those choices. At the same time, the Court of Appeals misunderstood pre-Bankruptcy Code law and ignored crucial differences between that law and present law. The resulting decision of the Court of Appeals is inconsistent with the language of the Bankruptcy Code, with congressional intent, and with several decisions of this Court.

REASONS FOR GRANTING THE WRIT

I. THE COURTS OF APPEALS, DISTRICT COURTS, AND BANKRUPTCY COURTS ARE DIVIDED ON WHETHER AN EQUITY-ONLY NEW VALUE RIGHT IS CONSISTENT WITH ABSOLUTE PRIORITY.

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court expressly declined to address the United States' argument as *amicus curiae* that Congress' "codification of the absolute priority rule eliminated any 'exception' to that rule suggested by [*Case v.*] *Los Angeles Lumber* [*Products Co.*, 308 U.S. 106 (1939)]." *Id.* at 203 n.3. The Court recognized, however, that the vitality

of the new value doctrine[2] is "a question which has divided the lower courts since passage of the Code in 1978." *Id.* The division over new value and absolute priority has intensified since *Ahlers*, the only consensus is the need for Supreme Court review.

A divided Seventh Circuit panel held in this case that a plan of reorganization may grant old equity, *and only old equity*, the right to purchase the ownership of the reorganized debtor without competitive bid or counter-proposal by creditors or others.[3] That holding sanctioned the conferral on old equity of what is in essence an "equity-only new value right."[4]

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[2] Like most other courts, this Court has referred to the new value doctrine as an "exception" to the absolute priority rule. *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18, 20 & n.1 (1994); *Ahlers*, 485 U.S. at 203 n.3. The majority opinion of the Court of Appeals panel in this case, for the most part, preferred the phrase "new value corollary." App. to Pet. for Cert. at 14a. We refer to the issue generally as the "new value doctrine" and to the new value issue involved in this case as an "equity-only new value right."

[3] It is not surprising that the Seventh Circuit panel was divided in this case. In *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1361-62 (7th Cir. 1990), Judge Easterbrook strongly suggested that the new value doctrine did not survive the enactment of the Bankruptcy Code. Later, in *In re Snyder*, 967 F.2d 1126, 1129-30 (7th Cir. 1992), Judge Cudahy strongly suggested just the opposite. In both cases, the panels held that even if the new value doctrine were viable, the debtor's proposed new value contribution did not satisfy the requirements of the doctrine. *See Kham & Nate's Shoes No. 2*, 908 F.2d at 1362; *Snyder*, 967 F.2d at 1131. The Seventh Circuit denied rehearing en banc in the case at bar by an evenly divided vote. *See* App. to Pet. for Cert. at 49a.

[4] A red herring frequently colors the arguments of debtors and courts in favor of an equity-only new value right. It is the erroneous conclusion that without an equity-only new value right, old equity would be barred from owning an interest in the reorganized debtor unless either (1) all classes of creditors accepted the plan or (2) all creditors were to be paid in full. The Ninth Circuit, for example, reasoned that if an equity-only new value right were

In five circuts, courts of appeals have taken positions on whether an equity-only new value right is inconsistent with the absolute priority rule of Section 1129(b). In addition to the Seventh Circuit's decision in this case, the Eighth and Ninth Circuits have authorized equity-only new value rights. *In re Ahlers*, 794 F.2d 388, 401-42 (8th Cir. 1986), *rev'd on other grounds*, 485 U.S. 197 (1988);[5] *In re Bonner Mall Partnership*, 2 F.3d at 907.[6] The Sixth Circuit has approved the confirmation of a plan containing an equity-only new value right without directly

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impermissible, "[w]e would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor [where senior classes are not paid in full]." *In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994). The law does not require, and ACLI does not suggest, that old equity may never own or control the reorganized debtor unless all classes of creditors either consent to the plan or are paid in full. The absolute priority rule does prohibit a plan that gives old equity greater rights to buy assets of or interests in the debtor than other parties in interest receive. For example, a new value right that is limited to old equity only is a grant of property to old equity on account of old equity's ownership of the debtor and triggers the prohibition of 11 U.S.C. § 1129(b)(2), as explained *infra* at 10-11.

[5] The Eighth Circuit decided *Ahlers* in a procedural posture in which no reorganization plan had been filed, and the court's opinion does not address specifically whether the debtors' right to purchase the equity in their farm would be exclusive. Instead, the contemplated new value considered by the Eighth Circuit was the debtors' "farm operation and management skills," which presumably could be provided only by the debtors. *Ahlers*, 794 F.2d at 402.

[6] In *Bonner Mall*, the Ninth Circuit held squarely that a plan may grant exclusively to old equity the right to purchase ownership for new value. 2 F.3d at 910-11. The Ninth Circuit's conclusion apparently was bolstered by its belief that the expiration of the debtor's exclusive period to file a plan under 11 U.S.C. § 1121 affected the propriety of the equity-only plan. *See id.* at 910 n.26. The issue in the instant case is the exclusivity of the right granted to old equity to purchase ownership of the debtor, not the exclusivity of the debtor's right to file a plan.

addressing the issue. *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986).

The Second Circuit recently addressed this issue at length and held that the absolute priority rule does not permit equity-only new value rights. *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Assocs., L.P.*, 1998 WL 90844, at *3 (2d Cir. Feb. 19, 1998). Earlier, the Fourth Circuit reached the same conclusion. *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992). And a panel of the Fifth Circuit initially so held, but the panel withdrew the relevant portion of its opinion after concluding that it did not need to reach the issue. *In re Greystone III Joint Venture*, 995 F.2d 1274, 1284 (5th Cir. 1991), *withdrawn in part*, 995 F.2d at 1284 (5th Cir.), *cert. denied*, 506 U.S. 821, 822 (1992).

This sharp division among the courts of appeals is alone sufficient to justify this Court's exercise of its certiorari jurisdiction. *See* Sup. Ct. R. 10(a). For a lender, however, the division among the bankruptcy courts has an even greater impact than the circuit split. Bankruptcy courts are responsible for applying the absolute priority rule in the first instance. The economics of many Chapter 11 cases limit lenders to proceedings in the bankruptcy court; costs and delay deter the first appeal to the district court or bankruptcy appellate panel, much less the second appeal to the court of appeals.

Because of the bankruptcy venue rules, sharp divisions among the courts on new value issues make it nearly impossible to evaluate the bankruptcy-related risk of a particular borrower. *See* 28 U.S.C. § 1408. For example, the principals of the debtor in *Coltex* surely regret filing for bankruptcy protection in New York, where their equity-only new value plan caused the Second Circuit to conclude that an equity-only new value right is impermissible. Had they filed in Delaware, where the debtor was organized, they might have found support for their position

in *In re VIP Motor Lodge, Inc.*, 133 B.R. 41 (Bankr. D. Del. 1991); had they filed in the Southern District of Texas, where the debtor's principal assets were located, they could have argued about new value on a clean slate.

And even if a creditor could somehow divine at the time of the transaction where the debtor might file for bankruptcy protection, it still might not know whether the debtor would receive the benefit of an equity-only new value right. In certain districts, the permissibility of an equity-only new value right may depend on the turn of the wheel that decides which judge is assigned the case. For example, in the Northern District of Georgia[7] and the Western District of Pennsylvania,[8] bankruptcy judges have published equity-only new value decisions in direct contradiction of their colleagues. In light of the split among the courts of appeals, there is little likelihood that these inter-district and intra-district divisions will be resolved consistently.[9]

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[7] *Compare In re Moonraker Assocs., Ltd.*, 200 B.R. 950, 954-56 (Bankr. N.D. Ga. 1996) (equity-only new value right is permissible) *with In re Homstead Partners, Ltd.*, 197 B.R. 706, 716 (Bankr. N.D. Ga. 1996) (equity-only new value right is not permissible).

[8] *Compare In re Tallahassee Assocs., L.P.*, 132 B.R. 712, 717 (Bankr. W.D. Pa. 1991) (equity-only new value right is permissible) *with In re Winters*, 99 B.R. 658, 663 (Bankr. W.D. Pa. 1989) (equity-only new value right is not permissible).

[9] Further confusion results from the inablity of courts that allow equity-only new value rights to agree about what old equity must offer to qualify. One common formulation of the requirements draws from *Los Angeles Lumber* the proposition that old equity must "offer value under the Plan that is (1) new, (2) substantial, (3) in money or money's worth, (4) necessary for successful reorganization, and (5) reasonably equivalent to the value or interest received." *In re Ambanc La Mesa Ltd. Partnership*, 115 F.3d 650, 654 (9th Cir. 1997), *cert. denied*, 118 S. Ct. 1039 (1998). (The debtor in *Ambanc* petitioned for certiorari, but its petition raised questions only as to the elements of the new value doctrine.) The courts' efforts to apply this test have led to numerous inconsistent results. *See* David R. Kuney & Timothy R. Epp, *Aftermath of*

II. THE AVAILABILITY OF AN EQUITY-ONLY NEW VALUE RIGHT IS AN ISSUE OF EXCEPTIONAL IMPORTANCE TO LENDERS AND BUSINESS OWNERS.

The reported cases discussed above reflect only a small portion of the impact of uncertainty about the new value doctrine upon creditors and debtors. In 1997, 9694 businesses filed for Chapter 11 protection, at least one in every judicial district in the United States. *See* Administrative Office of the U.S. Courts, *Calendar Year 1997 Shows Bankruptcy Filings Up 19 Percent Over 1996*, at tbl. F-2 (press release Feb. 27, 1998). Most decisions of bankruptcy courts in these Chapter 11 cases remain unreported. In many of these cases, creditors and debtors reach consensual solutions to disputed issues, after negotiations that are complicated by the uncertainty in this area of bankruptcy law.

The question of the existence and content of the new value doctrine is one of the most important issues of bankruptcy law today. The absolute priority rule lies at the heart of bankruptcy reorganization. It reflects the nonbankruptcy ordering of rights and priorities between holders of debt and equity and "sets the ground rules of Chapter 11." Douglas G. Baird, *The Elements of Bankruptcy* 73 (1992). If old equity is permitted an exclusive opportunity to capture the value of the reorganized debtor by contributing new capital to the debtor's estate at a price set by the bankruptcy judge, lenders will adjust their credit decisions to account for this upsetting of nonbankruptcy priorities.

The Court recognized the importance of the issue presented in this case by granting certiorari in *Bonner Mall*, but the parties' settlement prevented the Court from reaching the merits. *Bonner Mall*, 513 U.S. at 20 n.1. The

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Bonner Mall: *Evolution or Regression in the Notion of "New Value"?*, 5 J. Bankr. L. & Prac. 211, 234-46 (1996) (collecting cases).

issue is no less important today, as debtors and creditors continue to struggle with inconsistent interpretations of the absolute priority rule.

The importance of the proper application of the absolute priority rule also has a temporal reach far beyond bankruptcy proceedings. A lender making a determination whether to extend credit in the first instance must consider the worst possible outcome. For a lender, the worst possible outcome is (1) failure of the debtor to repay its obligations, followed by (2) a bankruptcy filing, followed by (3) failure of the debtor to propose a plan of reorganization that meets with the approval of the majority of a class of unsecured creditors, followed by (4) a cramdown that gives old equity, and only old equity, the opportunity to retain ownership of the debtor for "new value" at a price fixed by old equity and the bankruptcy judge rather than the market. In an environment in which lenders cannot predict whether a particular court will confirm a plan containing an equity-only new value right, a prudent lender will adjust its credit standards accordingly. The impact of such credit decisions on the capital markets nationwide argues strongly in favor of this Court's exercise of its jurisdiction to review the decision of the Court of Appeals.

III. THE DECISION OF THE COURT OF APPEALS IS INCONSISTENT WITH THE PLAIN MEANING OF SECTION 1129(b) OF THE BANKRUPTCY CODE, THIS COURT'S JURISPRUDENCE ON THE INTERPRETATION OF THE BANKRUPTCY CODE, AND BANKRUPTCY POLICY.

This case involves the text of a single subsection of the Bankruptcy Code, Section 1129(b)(2)(B)(ii). Twenty years ago, Congress codified the absolute priority rule, which previously was a matter of federal common law, as part of the Bankruptcy Code's requirement that a reorganization plan be "fair and equitable" to be confirmed over the objection of a class of creditors. 11 U.S.C.

§ 1129(b)(1). Section 1129(b)(2) provides that when a Chapter 11 plan is crammed down on a dissenting class of creditors, it is not fair and equitable unless:

> (B) With respect to a class of unsecured claims—
>
> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B). This is a clear congressional statement that if a class of unsecured creditors objects to a plan that does not propose full repayment of those unsecured creditors, a junior class cannot receive or retain any property under the plan because of its claim against or interest in the debtor. There is no dispute in the courts that an equity interest in the reorganized debtor, whatever its value, constitutes "property" for purposes of the absolute priority rule. *Ahlers*, 485 U.S. at 207-08. Similarly, old equity's exclusive opportunity to purchase this property is itself "property." *Bryson*, 961 F.2d at 504.

Section 1129(b)(2) does not prohibit old equity from becoming the owner of the reorganized debtor. Old equity has the same opportunity to purchase assets or ownership of the bankruptcy estate as any other interested investor. Section 1129(b)(2), however, does prohibit a Chapter 11 plan that confers an old equity greater rights to buy assets or ownership of the estate than other possible buyers have. A plan that provides for an equity-only new value right enables old equity to receive or retain property "on account of such junior . . . interest." 11 U.S.C. § 1129(b)(2)(B)(ii); *see also* App. to Pet. for Cert. at 34a-35a (Kanne, J., dissenting). The property received in violation of Section 1129(b)(2) is the exclusive opportunity to purchase ownership.

This Court's decisions on the interpretation of the Bankruptcy Code demonstrate that the Court of Appeals erred in affirming confirmation of respondent's plan. In *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), this Court stated:

> The task of resolving the meaning of [a section of the Bankruptcy Code] begins where all such inquiries must begin: with the language of the statute itself. In this case, it is also where the inquiry should end, for where, as here, the statute's language is plain, "the sole function of the courts is to enforce it according to its terms."

Id. at 241 (citations omitted). The Court of Appeals erroneously concluded that the language of the absolute priority rule was ambiguous because courts and commentators have reached different conclusions about its proper interpretation. *See* App. to Pet. for Cert. at 18a-19a. If disagreements among judges and scholars were sufficient to make a statute ambiguous, this Court would not have relied on the plain language of the Bankruptcy Code in *Ron Pair*. *See Ron Pair*, 489 U.S. at 238 & n.1 (collecting decisions and commentary reaching conflicting conclusions about interpretation of 11 U.S.C. § 506(b)); *see also Toibb v. Radloff*, 501 U.S. 157, 160-61 (1991) (following plain language of Bankruptcy Code despite disagreement among courts).

After concluding that the statute was ambiguous, the Court of Appeals turned for guidance to the law and practice under the Bankruptcy Act of 1898 (formerly codified at 11 U.S.C. § 1 et seq. (repealed 1979)) (the "Bankruptcy Act"). The Court of Appeals relied on this Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), in which the Court expressed its reluctance "to accept arguments that would interpret the Code, however vague the particular language under consideration might

be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Id.* at 419.[10] The Court of Appeals concluded that the new value doctrine had a longstanding heritage under the Bankruptcy Act and that Congress evidenced no intent to eliminate the doctrine when it enacted the Bankruptcy Code. *See* App. to Pet. for Cert. at 20a-23a. Both conclusions are incorrect.

The Bankruptcy Act heritage of the new value doctrine is limited at best. In *Los Angeles Lumber*, the Court considered whether the requirement in Section 77B of the Bankruptcy Act that a plan be "fair and equitable" required creditors to be accorded absolute priority or merely relative priority. Both Section 77B and Chapter X of the Bankruptcy Act, which had already superseded Section 77B by the time *Los Angeles Lumber* was decided, contained the phrase "fair and equitable" without further elaboration on the relative priority of creditors and old equity. *See* Act of June 7, 1934, ch. 424, sec. 1, § 77B(f), 48 Stat. 911, 919 (superseded 1938); 11 U.S.C. § 621(2) (repealed 1979). The Court held that absolute priority was required and then continued, in dicta, to describe a possible situation in which old equity could participate in a reorganization. *Los Angeles Lumber*, 308 U.S. at 115-16, 121-22.[11]

Neither in *Los Angeles Lumber* nor in any other published decision under the Bankruptcy Act from 1939 to 1978 did any court conclude that a new value exception to the absolute priority rule applied to the facts of a case. *See* Kenneth N. Klee, *Valuation and Cram Down*, SB37

[10] In *Dewsnup*, the Court also recognized that "where the language is unambiguous, silence in the legislative history cannot be controlling." *Id.* at 419-20. That principle should control this case.

[11] This Court stated shortly thereafter that the rule of absolute priority applied in Chapter X as well as under Section 77B. *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942).

ALI-ABA 455, 469 (1997); 7 *Collier on Bankruptcy* ¶ 1129.04[4][c], at 1129-107 (Lawrence P. King ed., 15th ed. rev. 1997); Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991). Accordingly, the pre-Bankruptcy Code new value doctrine existed only in dicta, in stark contrast to the line of Bankruptcy Act cases on the survival of liens that this Court found persuasive in *Dewsnup*. *See Dewsnup*, 502 U.S. at 418-19. More importantly, whatever new value exception existed under the Bankruptcy Act was available *only* where it had the approval of all classes of creditors. *See Los Angeles Lumber*, 308 U.S. at 114. It would not have applied to a case like the instant case, where the affected class has rejected the plan.

In 1978, Congress completely rewrote business bankruptcy reorganization law. *See Ron Pair*, 489 U.S. at 240 (recognizing that Congress "made significant changes in both the substantive and procedural laws of bankruptcy" and conducted "a substantial overhaul of the system"). In the Bankruptcy Code, Congress for the first time enunciated what makes a plan of reorganization "fair and equitable." 11 U.S.C. § 1129(b)(2). Congress codified the absolute priority rule, which was a solidly established rule under Chapter X of the Bankruptcy Act, but made no mention of the new value doctrine, which was a part of Bankruptcy Act practice only in theory. To the extent that the new value doctrine was a part of past practice at all, this congressional decision alone is "a clear indication that Congress intended . . . a departure" from past practice. *See Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990); *Union Bank v. Wolas*, 502 U.S. 151, 160 (1991) ("[T]he fact that Congress carefully reexamined and entirely rewrote the preference provision in 1978 supports the conclusion that the text of § 547(c)(2) as enacted reflects the deliberate choice of Congress.").

The House Report accompanying the bill that enacted the Bankruptcy Code stated that the bill contained "a

partial application of the absolute priority rule now applied under Chapter X" and a "*partial* codification of the absolute priority rule." H.R. Rep. No. 95-595, at 224, 414 (1977) (emphasis added), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6184, 6370. This legislative history reflects Congress' intent to rework the law of business reorganization significantly, adopting the absolute priority rule from one chapter of the Bankruptcy Act and applying it in modified form. Whatever role the new value doctrine may have played in Bankruptcy Act practice, Congress did not intend to import it into the Bankruptcy Code.

Other actions further demonstrate Congress' intent to rework the law of business reorganization. Among the significant changes wrought by Congress was the replacement of three business reorganization chapters of the Bankruptcy Act (Chapters X, XI, and XII) with a single chapter in the Bankruptcy Code (Chapter 11). Chapter 11 of the Bankruptcy Code incorporated certain features of the Bankruptcy Act's reorganization chapters and included several important new provisions:

- Chapter X of the Bankruptcy Act required the appointment of a disinterested trustee to manage any debtor with liabilities of $250,000 or more. 11 U.S.C. § 556 (repealed 1979). In contrast, the debtor normally remained in possession of its assets under Chapters XI and XII. 11 U.S.C. §§ 742, 844 (repealed 1979). In the Bankruptcy Code, Congress drew on Chapters XI and XII and created a preference for debtor control except in extraordinary situations. *See* 11 U.S.C. §§ 1104(a), 1107(a).

- Any party in interest could propose a reorganization plan in Chapter X of the Bankruptcy Act. 11 U.S.C. § 569 (repealed 1979). Only the debtor could propose an arrangement in Chapters XI and XII. 11 U.S.C. §§ 706(1), 723, 823 (repealed 1979). Congress created a hybrid rule in Bankruptcy Code, giving the debtor-in-possession the exclusive right to propose a plan for the first 120 days after the entry of an order for relief and allowing the court to extend that exclusive period. 11 U.S.C. § 1121.

- The absolute priority rule applied rigorously in cases under Chapter X of the Bankruptcy Act; the affected creditors were not permitted to consent to non-priority treatment in a reorganization plan. *Los Angeles Lumber*, 308 U.S. at 114. The "fair and equitable" standard, including the absolute priority rule, did not apply at all in Chapters XI and XII after Congress amended the Bankruptcy Act in 1952. *SEC v. American Trailer Rentals Co.*, 379 U.S. 594, 606 n.8 (1965); *In re Mallard Assocs.*, 475 F. Supp. 1045, 1053 (S.D.N.Y. 1979). In the Bankruptcy Code, Congress imported the absolute priority rule from Chapter X of the Bankruptcy Act, codified it for the first time, and made it applicable only when a class of creditors dissents (and then only as to the dissenting class). *See* 11 U.S.C. § 1129(a)-(b).

In sum, Congress created a new law of business reorganization in 1978, adopting elements of the reorganization chapters of the Bankruptcy Act that it found worthwhile. The decision of the Court of Appeals ignores the plain language of the Bankruptcy Code and reads into the Bankruptcy Code an unwarranted intent to continue pre-Bankruptcy Code practices.

Congress' rewriting of bankruptcy law in 1978 also reflected a shift in policy. Especially in the area of plan confirmation, Congress gave responsibility to parties in interest, rather than judges, to determine what is in the parties' best interests. In some cases, creditors may conclude that they will benefit if old equity retains ownership and, in appropriate cases, management control of the reorganized debtor. Empirical evidence suggests that creditors frequently accept plans that would not satisfy the absolute priority rule. *See* Lynn M. LoPucki & William

C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990); Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989).

The equity-only new value right approved in the instant case operates differently, however, as the Seventh Circuit explained in another case:

> Creditors effectively own bankrupt firms. They may find it worthwhile, as owners, to sell equity claims to the managers; they may even find it worthwhile to give the equity away in order to induce managers to stay on and work hard. . . . When there is value to be gained by allowing a lower class to kick in new value and keep its interest, the creditors should be willing to go along. A "new value exception" means a power in the *judge* to "sell" stock to the managers even when the creditors believe that this transaction will *not* augment the value of the firm.

Kham & Nate's Shoes No. 2, 908 F.2d at 1360 (citation omitted). This Court recognized as much in *Ahlers*:

> [T]he Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which . . . fails to honor the absolute priority rule.
>
> The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code.

Ahlers, 485 U.S. at 207 (citation omitted).

The decision of the Court of Appeals places the bankruptcy judge in the position of first determining that old equity's proposed payment is "necessary" and "substantial" (without determining whether creditors or others would be willing to pay the bankruptcy estate the same amount

or more) and then deciding that it is in the creditors' best interests that old equity receive ownership of the reorganized debtor in exchange for this payment. As Congress directed in the Bankruptcy Code and this Court recognized in *Ahlers*, that decision is for the creditors to make.

CONCLUSION

For the reasons stated herein and in the Petition for Writ of Certiorari, the Petition should be granted.

Respectfully submitted,

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